United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

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P/S

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

- x

In the Matter of ALPHONSE GUARIGLIA,

:

Bankrupt, Appellee

No. 74-2440

- against - :

COMMUNITY NATIONAL BANK AND TRUST COMPANY,

:

Creditor, Appellant

- x

BANKRUPT - APPELLEE'S BRIEF

APPEAL FROM AN ORDER OF THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF
NEW YORK

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QUESTIONS PRESENTED

1. Whether the District Court erred in finding that the Bankruptcy Court has the power to enjoin enforcement of a Civil Court order punishing a bankrupt for contempt.

2. Whether the District Court erred in finding that the Bankruptcy Court properly exercised its discretion in enjoining enforcement of the Civil Court contempt order to prevent frustration of the purposes of the Bankruptcy Act.

STATEMENT OF THE CASE

a) Preliminary Statement

This is an appeal from an order of the United States District Court, Eastern District of New York (Bartels, J.) entered on September 30, 1974, which affirmed an order of the Bankruptcy Court (Price, J.) entered on February 27, 1974,

enjoining the appellant Community National Bank and Trust Company, its agents and employees, from ever enforcing an order of the Civil Court of the City of New York, County of Richmond, punishing the bankrupt, Alphonse Guariglia, for contempt of Court.

b) Statement of Facts and Proceedings Below

In May 1969 the appellant, Community National Bank and Trust Co., obtained a judgment in the Civil Court of the City of New York, County of Richmond, against the appellee, Mr. Guariglia, in the amount of $4,755 (A-4). On September 15, 1972 the bank, by its attorney Mr. Reuben E. Gross, Esq., issued an information subpoena pursuant to Section 5223 of Article 52 of the Civil Practice Law and Rules requiring Mr. Guariglia and his wife to answer interrogatories regarding their assets as part of its effort to enforce the judgment. (A-50) The subpoena was served on Mr. & Mrs. Guariglia on October 28, 1972. Neither Mr. nor Mrs. Guariglia responded to the subpoena because they did not understand what it was. Instead Mr. Guariglia took it to Mr. Joseph L. Belvedere, Esq., whom he had retained on October 26, 1972 for the purpose of representing him in a bankruptcy proceeding which he desired to bring. In early November the bank's attorney, Mr. Gross, obtained an order in Civil Court requiring Mr. Guariglia to show

cause why he should not be held in contempt of court for failing to comply with the information subpoena. The process server, however, was never able to serve the order on Mr. Guariglia. On November 28, 1972 Mr. Gross obtained a second order to show cause returnable on December 22, 1972. (A-51) This order was served on Mr. Guariglia. Mr. Guariglia did not appear because he did not understand the order. Instead he took the paper with which he had been served to his attorney, Mr. Belvedere.

In a letter dated December 22, 1972, Mr. Gross notified Mr. Guariglia that a bailable attachment would be issued and offered him an opportunity to resolve the matter. (A-51) Mr. Guariglia took the letter to his attorney. On December 29, 1972 a bailable attachment was issued by the Civil Court. (A-51)

In the beginning of January 1973, Mr. Guariglia's attorney telephoned Mr. Gross. It was agreed that Mr. & Mrs. Guariglia would be examined in Mr. Gross's office in answer to the information subpoena of September 15, 1972. During the telephone conversation Mr. Belvedere informed Mr. Gross that he was going to file a petition in bankruptcy on behalf of Mr. Guariglia. Mr. Gross requested that he delay filing it so that Mr. Gross could hold the examination after he had returned from a short vacation which he was planning. Mr. Belvedere agreed. It was

jointly agreed that Mr. & Mrs. Guariglia would appear in Mr. Gross's office on February 15, 1972. (A-51) It was also agreed that since Mr. Belvedere could not be present at the examination the transcript of the examination would not be signed until Mr. Belvedere had a chance to read it. (A-51)

Meanwhile on February 7, 1973 Mr. Belvedere filed a petition in bankruptcy in the United States District Court for the Eastern District of New York on behalf of Mr. Guariglia. (A-51) The petition, which had been executed on January 10, 1973, listed the debt to the bank as a liability in Schedule A-3. (A-14)

The case was referred to Bankruptcy Judge Manuel J. Price. Bankruptcy Judge Price scheduled the first meeting of creditors for February 22, 1973. (A-51) On February 9, 1973 notice of the meeting was sent to all creditors including the appellant bank. (A-51) The notice fixed April 11, 1973 as the last day to file specifications of objections to the bankrupt's discharge and to file applications as provided in Section 17a of the Bankruptcy Act to determine the dischargeability of debts claimed to be nondischargeable pursuant to clauses (2), (4) or (8) of Section 17a of the Bankruptcy Act. (A-52).

On February 15, 1973, as previously arranged, the bankrupt and his wife appeared at Mr. Gross's office and fully answered all questions put to them concerning their assets. (A-52) Their testimony was transcribed and on February 20, 1973 a copy of the transcript was sent to Mr. Belvedere. (A- 52)

On February 22, 1973 the first meeting of the creditors was held. (A-52) Neither the bank nor any other creditor appeared. (A-52) Judge Price examined the bankrupt and appointed a trustee. (A-52) Thereafter, on May 22, 1973, the bankrupt made a motion to amend Schedule A-3 of the petition in bankruptcy to add a creditor which had inadvertently been left out. (A-52) Judge Price granted the motion and extended the time to file specifications of objection to discharge and applications to declare debts non-dischargeable to July 16, 1973. (A-53).

On March 12, 1973 Mr. Gross wrote to Mr. Belvedere and requested him to promptly return the signed transcript. Mr. Belvedere returned the signed transcript to Mr. Gross on April 10, 1973. (A-52)

On May 14, 1973 Mr. Gross moved in the Civil Court of the City of New York, County of Richmond, pursuant to CPLR §5251 for an order adjudging Mr.

Guariglia and his wife in contempt of court on the ground that they had disobeyed the subpoena dated September 15, 1973. (A-53) The relief sought by the bank was a fine in the full amount of the 1969 judgment. (A-53) Mr. Guariglia opposed the motion. He was represented by Mr. Abraham Fleishmen, Esq., an associate of Mr. Belvedere who submitted affidavits by Mr. Guariglia and Mr. Belvedere in opposition. (A-53) However, on June 19, 1973 Judge Jerome Otis Ellis found Mr. Guariglia in contempt of court for failure to obey the September 15, 1974 subpoena and fined him $4,755, the full amount of the 1969 judgment, plus $50 costs. (A-53) The order required Mr. Guariglia to pay the fine in weekly installments in the amount of $20 per week. (A-53) It also provided that upon failure to pay the fine or any installment thereof, the entire balance would become due and an order for Mr. Guariglia's commitment would issue on three days notice, commiting him to civil jail until he paid the fine or was discharged according to law. (A-53)

On July 5, 1973 The Legal Aid Society, which had agreed to represent Mr. Guariglia because he could no longer afford to retain private counsel, applied to the bankruptcy court for a temporary and permanent

injunction restraining the bank from requiring Mr. Guariglia to comply with the Civil Court order on the ground that a stay was necessary to prevent a total frustration of the purposes of the Bankruptcy Act. (A-12, 13) Referee Joseph V. Costa acting for Referee Manuel J. Price granted an order restraining the bank from enforcing the Civil Court contempt order pending a hearing and determination of the bankrupt's application. (A-13)

A hearing was held before Bankruptcy Judge Manuel J. Price. The bank opposed the motion on the ground that the bankruptcy court could not look behind the civil court judgment to punish for contempt and that the bank's motion and the fine imposed were proper because of the fact that the signed transcript had not been returned until April 11, 1973, the last day fixed in the first meeting notice to file specifications of objection to discharge, etc. The bank argued that this delay was prejudicial because the bank was not left with adequate time to object to the discharge or to make application to declare its debt non-dischargeable if it had so wished. (A-56)

In a decision dated February 20, 1974, Bankruptcy Judge Price rejected the bank's argument that it was prejudiced by the belated return of the signed transcript. (A-56)

a judgment." (Id at 26)

He stated that the bank's attorney had examined the bankrupt on February 15, 1973 and that if based upon the examination it had had any basis for filing specifications of objections to discharge and applications to declare debts non-dischargeable it could have filed the necessary papers in court prior to receiving the signed transcript. He noted that the Bankruptcy Act does not require that the basis for specifications, etc., must be a written, signed examination. He also stated that if the bank had felt it needed more time it could have made an ex parte application for an extension of time to file. The attorney for the bank, Judge Price found, knew that such application are granted almost on a pro forma basis. Further, he added that all of this was unnecessary because he had in fact required the bankrupt, as a condition to permitting him to amend his schedule, to extend the time to file specifications etc. to July 16, 1973. This order, he stated, was signed on June 7, 1973. (A-57)

Bankruptcy Judge Price found that the examination evidently disclosed no grounds for objections because the bank did not file such an application even though it had until July 16, 1973 more than three months after its attorney received the signed transcript from Mr.

Guariglia, to do so. (A-57) He concluded, therefore, that the bank had used the motion to punish Mr. Guariglia for contempt and to fine him in the full amount of its 1969 judgment as a means of circumventing the discharge of its obligation. (A-57)

Judge Price rejected as well the argument that the bankruptcy court did not have the authority to look behind a civil court order punishing the bankrupt for contempt of court. (A-57, 59) He held that the power to protect a bankrupt from oppressive action by a judgment creditor in state court when the judgment is dischargeable in bankruptcy is inherent in the bankruptcy court as a court of equity. (A-58) Using the guidelines laid down by the United States Supreme Court in Local Loan Company v. Hunt, 292 U.S. 234 (1934) he concluded that unusual circumstances exist in the present case which justify the exercise of the court's equitable power. (A-62) These circumstances included the fact that the bankrupt had no legal remedy adequate to meet the requirements of justice unless the bankruptcy court exercised its equitable power. (A-60) An application to the Civil Court by the bankrupt to be relieved of his contempt, Judge Price stated, while theoretically possible, was in reality a futile measure in view of the fact that the Court had already

fined him almost $5,000. The bankrupt could not appeal from the judgment because his time to do so had expired. Moreover, the law of the state was against him. Accordingly, Judge Price found that unless the bankruptcy court exercised its equitable power the bankrupt would be faced with either paying the fine or being committed to civil jail in spite of the fact that there was no real basis for the contempt. (A-61)

On February 27, 1974 an order was entered in the United States District Court for the Eastern District of New York which restrained the bank from ever enforcing the Civil Court order punishing Mr. Guariglia for contempt of court. (A-47) On March 5, 1974 the bank appealed from the order of the bankruptcy court.

In a decision dated September 30, 1974, Judge John R. Bartels affirmed the order of the bankruptcy court. (A-3) Addressing himself to the question of the court's power, he stated that "there can be no doubt that the bankruptcy court has authority to entertain the present application to stay the state court action."(A-8) Addressing himself to the question of whether "unusual circumstances" existed justifying the exercise of that power, Judge Bartels stated "if the contempt proceeding is a step to

collect a judgment, then it should be stayed, the test being whether the fine was imposed by the state court to uphold its dignity or whether in effect it was a circumvented method of collecting the judgment otherwise dischargeable in bankruptcy." Finding that the contempt here involved is not a criminal contempt , that the order did not require the fine to be paid into court, and that the fine equalled the amount of the judgment plus $50 costs, Judge Bartels concluded that unusual circumstances were present which warranted the bankruptcy court's exercise of its inherent equity powers. (A-10, 11)

SUMMARY OF ARGUMENT

The power of the Bankruptcy Court to enjoin the enforcement of the Civil Court order punishing the bankrupt for contempt of court has two independent bases. It derives from federal statutes and its inherent powers as a court of equity.

The power being present, its exercise here was wholly proper to prevent a frustration of the fundamental purposes of the Bankruptcy Act.

POINT I

THE BANKRUPTCY COURT HAS THE POWER TO ENJOIN ENFORCEMENT OF A CIVIL COURT ORDER PUNISHING A BANKRUPT FOR CONTEMPT

Federal courts including federal bankruptcy courts are authorized by 28 U.S.C. §§2283 to enjoin state court proceedings for any one of the following three reasons: (1) to aid its jurisdiction; (2) to effectuate its judgments; (3) or where an injunction is expressly authorized by Act of Congress.

A bankruptcy court is expressly authorized by Section 11(A) of the Bankruptcy Act, 11 U.S.C. §29(a) to enjoin "A suit which is founded upon a claim from which a discharge would be a release, and which is pending against a person at the time of the filing of a petition by or against him . . . until an adjudication or dismissal of the petition . . ." The purpose of this provision is to afford the bankrupt protection from unnecessary harassment by creditors. In re S.W. Strauss & Co., 6 F. Supp. 546, 548 (E.D.N.Y. 1934).

In addition, Section 2a of the Act, 11 U.S.C. §11(a) specifically invests courts of bankruptcy "with such jurisdiction at law and in equity as well enable them to exercise original jurisdiction in proceedings under this Act, . . ."

Consequently, the Supreme Court has repeatedly held that the bankruptcy court is a court of equity with unusual equity powers including the power to enjoin state court proceedings.

In Local Loan Co. v. Hunt, 292 U.S. 234, 240 (1934), the United States Supreme Court found that "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity." In Pepper v. Litton, 308 U.S. 295, 304 (1939), the Supreme Court, speaking of the bankruptcy court's broad equitable powers, said:

> The bankruptcy courts have exercised these equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates. They have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done. (Empasis added).

In this case the Supreme Court held that the federal bankruptcy court had the power to disregard a state court judgment even though the trustee in bankruptcy had been defeated in a state court action which he

had brought to set it aside. See also Continental Ill. N.B. & T. Co. v. C.R.I. & P.R. Co., 294 U.S. 648, 675 (1934); Ex Parte Baldwin, 291 U.S. 610, 616 (1933); Collier on Bankruptcy, Vol. I, ¶2.09, p. 173.

None of the cases cited by the appellant in his brief in which the courts decline to enjoin state court contempt proceedings detract from the fundamental principle that a bankruptcy court has the power to enjoin such state court proceedings. Rather, as we shall show below, those cases merely hold that in the context of factual patterns completely distinguishable from the facts of the present case, the bankruptcy court had abused its discretion in exercising its power.

POINT II

THE BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN ENJOINING ENFORCEMENT OF THE CIVIL COURT CONTEMPT ORDER TO PREVENT FRUSTRATION OF THE PURPOSES OF THE BANKRUPTCY ACT

In Local Loan Co. v. Hunt, supra, 292 U.S. at 241, the United States Supreme Court stated that while a bankruptcy court has the power to enjoin state court proceedings it should only exercise this power where unusual circumstances exist. In that case the bankrupt's employer was sued in a state court by a creditor on an assignment of wages on a debt discharged in the federal bankruptcy court. Instead of intervening in the state court action the bankrupt applied to the bankruptcy court for an injunction, which was granted. The Supreme Court found that the bankruptcy court had been justified in exercising its authority in light of the unusual circumstances present:

> So far as appears, the municipal court was competent to deal with the case. It is true that

> respondent was not a party to the litigation; but undoubtedly it was open to him to intervene and submit to the court the question as to the effect upon the subject matter of the action of the bankruptcy decrees. And it may be conceded that the municipal court was authorized in the law action to afford relief the equivalent of that which respondent now seeks in equity. Nevertheless, other considerations aside, it is clear that the legal remedy thus afforded would be inadequate to meet the requirements of justice. As will be shown in a moment, the sole question at issue is one which the highest court of the state of Illinois had already resolved against respondent's contention. The alternative of invoking the equitable jurisdiction of the bankruptcy court was for respondent to pursue an obviously long and expensive course of litigation, beginning with an intervention in a municipal court and followed by successive appeals through the state intermediate and ultimate Courts of Appeal before reaching a court whose judgment upon the merits had not been predetermined. (Id at 241)

The Supreme Court not only upheld the action taken by the bankrupt in bypassing the state court and the action taken by the federal bankruptcy court in

enjoining the state court proceedings but, in addition, it held that the rule of the highest court of the state of Illinois which treated an assignment of future wages as a valid lien under §67(d) of the Bankruptcy Act was violative of the spirit and purpose of the Act and therefore incorrect.

On the basis of Local Loan Co. v. Hunt, supra the court in the Matter of Forgay, 140 F. Supp. 473 (C.D. Utah, 1956) held that unusual circumstances justifying the exercise of its injunctive power existed where loan company during the pendency of a bankruptcy proceeding, wherein its loan was listed as a liability, totally ignored the proceeding and obtained a default judgment against the bankrupt in state court. The bankruptcy court enjoined proceedings to enforce the judgment despite the fact that the judgment was based on allegations that the bankrupt had engaged in fraudulent conduct.

> A creditor who so ignores the bankruptcy court and who seeks to pursue his remedies in the state court manifestly is circumventing the bankruptcy proceedings. He obtains an advantage over

> the other creditors of the bankrupt. If one creditor ignores the notice of the bankruptcy court and seeks his remedy in the state court claiming fraud, why not all creditors? This conduct on the part of the creditors, if encouraged, portends the disintegration of the bankruptcy system and its orderly administration. There is no justification for federal courts to abdicate their authority to the state courts, jeopardize the usefulness of the Bankruptcy Act, permit the confusion and harassment of the honest debtor, give advantage to the unscrupulous creditor and contribute to the lack of public faith in the proceeding itself. (Id at 480)

As Judge Bartels found in his decision in this case, there are present here unusual circumstances justifying the exercise by Judge Price of the bankruptcy court's inherent equity powers.

One of the primary purposes of the Bankruptcy Act is to free the deserving debtor from the burden of unpaid debts. The Supreme Court has consistently recognized that the substantial and fundamental purpose underlying the bankruptcy law is to give a debtor a "new opportunity in life and a clear field

for future effort, unhampered by the pressure and discouragement of pre-existing debt." Local Loan Co. v. Hunt, 292 U.S. 234, 244-245 (1934); Lines v. Frederick, 400 U.S. 18 (1970). See also Fallick v. Kehr, 369 F.2d 899 (2nd Cir., 1966).

The record clearly shows that the appellant bank moved in civil court to hold the bankrupt and his wife in contempt of court for failure to comply with the September 15, 1972 information subpoena and for a fine in the full amount of the judgment despite the fact that the bankrupt and his wife as per the agreement of the parties personally appeared at the office of the bank's attorney and fully answered all questions put to them concerning their assets. The bank contends that the order and fine were justified because although the bankrupt appeared and supplied all the information which the subpoena had been issued to obtain, the bankrupt did not promptly return the signed transcript of the examination. This delay, contends the bank, was prejudicial because it did not permit the bank sufficient time to prepare and file an objection to the discharge or to make application

to declare its debt nondischargeable if it had so desired.

Judge Price found the bank's argument to be meritless, and there is no basis for overturning his carefully reasoned conclusion.

The tenuous rational given by the bank for its motion illuminates the unfairness and impropriety of its action. Far from the bankrupt having abandoned its state court appeal in favor of applying for relief to the bankruptcy court, it is the creditor who, fearing with good reason that its debt would be discharged in bankruptcy court, abandoned its sole remedy in bankruptcy court and sought to immunize the debt from discharge by having a state court convert the debt into a fine for contempt. Judge Price properly enjoined the creditor from taking advantage of the civil court contempt order to prevent a total frustration of the fundamental purpose of the Bankruptcy Act and to protect the integrity of his own order of bankruptcy.

The result in this case is fully supported by the decision of Bankruptcy Judge Asa Herzog in The Matter of Zeckendorf, No. 68B 750, (S.D.N.Y. 1969)

(copy of decision annexed hereto). In that case a judgment creditor had moved in state supreme court pursuant to section 5251 of Article 52 of the CPLR, entitled "Money Judgments - Enforcement", which makes failure to comply with a restraining notice or subpoena punishable as a contempt of court, to hold the bankrupt in contempt for allegedly transferring property in violation of the restraining notice and for failing to appear at an examination in proceedings supplementary to judgment. Judge Herzog enjoined the judgment creditor from proceeding further in state court.

Commenting at the outset, on the cases where courts have refused to grant injunctions precisely because the state court proceedings were to punish for contempt, Judge Herzog said:

> Unfortunately, such decisions do not look behind the "contempt" label while denying the injunctive relief intended by the provisions of the Bankruptcy Act. There is nothing sacrosanct about the word "contempt" and it would seem that the particular contempt proceeding should be scrutinized to determine whether they are aimed at punishing an affront to the dignity of the court or whether they are but a

step in the collection of
a judgment. (Id at 26)

Judge Herzog in his opinion stated that when what is involved is not an affront to the dignity of the court but rather a nominal or technical contempt proceeding which is nothing but a step in the collection of a judgment, the court should enjoin the proceeding to prevent a violation of the letter and spirit of the Bankruptcy Act:

> If the purpose of §11a is to relieve the bankrupt from unnecessary harassment by creditors, as Judge Patterson pointed out in In re S.W. Straus & Co., 6 F. Supp. 547, 548 (E.D. N.Y. 1934), then surely the court should enjoin a technical contempt proceeding which looks to collection of a judgment rather than to vindicate the dignity of the court.
>
> While it is undoubtedly true that a true contempt involving an affront to the dignity of the court does not lose that character because of statutory authorization to turn over the amount of the fine to the person aggrieved by the offender's conduct, 170 F. at 720, it seems to me that where such an affront is not involved, and where the relief sought is a fine in the amount of the judgment and payable to the judgment creditor,

> it is an indication that the major purpose of the proceeding is the enforcement of the money judgment. This is an important consideration, for, should the bankrupt later win a discharge, the situation would be one where the creditor would obtain payment out of the bankrupt's earnings after adjudication, in violation of a fundamental purpose of the Bankruptcy Act. See In re Brecher, 19 F. Supp. 283 (S.D.N.Y. 1937, Patterson, J.). (Id at 26) (Emphasis added)

Applying these principles to the facts before him he found that if indeed the debtor had failed to comply with the subpoena and the restraining order he was guilty of contempt only because Section 5251 of Article 52 makes such a failure punishable as a contempt of court. The bankrupt, he said, did not disobey an order made by the court. The act complained of was not committed in the presence of the court. In addition, the application by the creditor for a fine in the amount of the transferred property to be paid to the creditor indicated that he was pursuing a technical contempt to collect his judgment. These findings as observed by both Judges Price and Bartels in their respective decisions are equally applicable in the case at bar.

Although the question of the dischargeability

of a compensatory fine was not yet in issue in In Re Zeckendorf, since that case involved Chapter XI proceedings and therefore Section 314 of the Bankruptcy Act, 11 U.S.C. § 714 , which does not make dischargeability of the debt a precondition for a stay, Judge Herzog contemplating a time when the debtor would be adjudged a bankrupt and the court would be dependent on Section 11 of the Bankruptcy Act, 11 U.S.C. §29, noted with approval the holding in Parker v. United States, 153 F. 2d 66 (1st Cir. 1946). In that case the court held that a compensatory fine imposed in a civil proceeding was a debt within the meaning of § 1(14) of the Bankruptcy Act, 11 U.S.C. § 1 (14) and a provable debt under §63 of the Act, 11 U.S.C. §103, insofar as it is "a fixed liability, as evidenced by a judgment . . . absolutely owing at the time of the filing of the petition in bankruptcy." In addition, such a debt does not come within the purview of Section 17 of the Bankruptcy Act, entitled "Debts Not Affected By Discharge." See also In Re Mann, 126 F. Supp. 709 (D. Mass. 1954).

Judge Herzog's position is amply supported by legal precedent. In In Re Lenoble, 79 F. Supp. 457, 458 (S.D.N.Y. 1948), in which the court denied a motion to vacate its order restraining the judgment creditor during the pendency of the bankruptcy proceeding from taking steps to collect on the judgment, the Court said:

> The restraining order does not appear to prevent the judgment credit or her attorney from bringing contempt proceedings in the state court; it merely restrains the taking of further steps to collect the judgment. If the contempt proceeding is a step to collect the judgment then it is properly restrained. If the contempt proceedingsis not such a step, there is no need for modification. The restraining order staying the taking of further steps to collect the judgment is proper.

Similarly in In re Fortunato, 123 F. 62, 63 (S.D.N.Y. 1903), where a judgment creditor of the bankrupt after the entering of an order by the bankruptcy court enjoining him from taking any further steps to collect the judgment, applied for and obtained an order from the state court adjudging the bankrupt in contempt for failure to obey an order for examination made prior to the bankruptcy and requiring him to pay a fine equal

to the judgment and costs, the district court upon holding the creditor in contempt of its order stated:

> They allege in defense of their action that the injunction did not effect the right of the City Court to punish a contempt committed before the injunction was granted. Undoubtedly, a court may, on its own motion, punish for a contempt, but such a contempt as took place in this case was inherently entirely different from a contempt which courts ordinarily punish on their own motion, such as, for instance, a personal insult offered to the court. A proceeding for punishing a person for refusal to comply with an order of the court on the ground that it is contempt is usually in substance a mere proceeding in an action, instigated and carried on by a party to the action, or his attorney, as a step in the prosecution of the suit. In this case the fine was measured by the amount of the judgment and the attorney's costs in the special proceeding. It was directed to be paid to the judgment creditor or his attorneys. It was not at all in the nature of a punishment inflicted by the court, on its own motion, for the protection of its own dignity, but was simply a proceeding carried on by the plaintiff's attorneys for the purpose of collecting the judgment. But even if the proceedings in their nature had been proceedings by the court to vindicate its own authority, Hoffman & Wahle and their clerk were enjoined from instituting them or taking any part in them.

In In Re Adler, 144 F. 659, 661 (2nd Cir.) cert. den. 201 U.S. 647 (1906) the Court of Appeals, which upheld a district court order enjoining a judgment creditor of the bankrupt from attempting to enforce its judgment by supplementary proceedings in state court to punish the bankrupt for contempt of court, said:

> It would seem, therefore, that it was the duty of the court to stay contempt proceedings if the claim were one which could be proved and discharged in bankruptcy; surely to do so was within the sound discretion of the judgment.

The cases cited by the bank in which the courts held that the bankruptcy court could not enjoin state court proceedings to punish the bankrupt for contempt committed prior to the filing of the petition in bankruptcy do not, as previously noted, hold that the bankruptcy court is devoid of power to enjoin the proceeding but rather that to do so under the circumstances was an abuse of its discretion,

and they are wholly distinguishable from the case at bar. These cases all of which predated the change in policy announced by the Supreme Court's decision in Local Loan Co. v. Hunt, supra, 292 U.S. 234 (1934) at base rest on the Court of Appeals decision in Matter of Koronsky, 170 F. 719 (2nd Cir. 1909). In Koronsky the bankrupt was found guilty of contempt and fined for a deceit practiced upon the court in moving to vacate a default judgment on perjurious affidavits. The Court held that:

> Manifestly, the offense was one peculiarly against the court, and of the sort where the punishment of the offender is a vindication of the dignity of the Court. (Id at 720).

The Court in Koronsky did not indicate what its attitude would have been if the dignity of the court had not been offended. In addition, as noted by Judge Price, all of the cases cited by the appellant bank including Koronsky involved situations where the judgment creditor was frustrated in his attempts to collect his judgment. Accordingly, Koronsky is distinguishable from the case at bar because it did not involve unusual circumstances

which would justify an injunction.

The cases that rely upon Koronsky, many of which are neither well written nor well reasoned, are also distinguishable on the ground that they did not involve special circumstances. In In Re Metz, 6 F.2d 962 (2nd Cir. 1925) the Court refused to enjoin a state court proceeding to punish the bankrupt for failure to comply with a judgment because the judgment itself was not dischargeable in bankruptcy. The judgment had been entered for the creditor upon a finding that the bankrupt had fraudulently misappropriated money for the purpose of making his corporation insolvent and thus unable to pay its debt to the creditor. The Court held that in passing upon an application for a stay under Section 11 of the Bankruptcy Act the judge must look to the nature of the debt. In In Re Hall, 170 F. 721 (S.D.N.Y. 1909) which is cited as authority in the aforementioned case, the Court makes the unqualified statement that fines for contempt are not dischargeable in bankruptcy but does not support its statement. Further there is no indication of what the underlying circumstances were. The bank's reliance on In Re Thomashefsky, 51 F. 2d 1040 (2nd Cir. 1931), is misplaced since that case involved a fine

for failure to appear in supplementary proceedings which had been imposed before the filing of the petition in bankruptcy. Hence there was, unlike in the case at bar, no question of an attempt to circumvent the purpose of the Act. In Re Francisco, 245 F. 216 (N.D.N.Y. 1917), which is relied upon by the Court in Thomashefsky, putting aside the decision's paucity of reasoning, is distinguishable because it involved an affront to the dignity of the court. Similarly in People ex rel Otterstedt v. Sheriff of Kings County, 206 F. 566 (E.D.N.Y. 1913) the contempt again involved an affront to the court's dignity for failure to obey the court's restraining order.

CONCLUSION

FOR THE ABOVE STATED
REASONS THE ORDER BELOW
SHOULD BE AFFIRMED

Dated: New York, New York
January 2, 1975

Respectfully submitted,

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BANKRUPTCY COURT ENJOINS PARTIES FROM FURTHER PROCEEDINGS IN STATE COURT CONTEMPT ACTION

An opinion by Referee Asa S. Herzog of the Southern District of New York recommended for publication in full by former Digest Editor Saul Seidman, District of Connecticut.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the matter of
WILLIAM ZECKENDORF, a/k/a
WILLIAM ZECKENDORF, SR.,
Debtor

IN PROCEEDINGS FOR
AN ARRANGEMENT
No. 68 B 750

APPEARANCES:
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Attorneys for Debtor
1290 Avenue of the Americas
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ROBERT F. HERZOG and
JULES TEITELBAUM, ESQS.
Attorneys for Fried, Beck & Tannenbaum

ASA S. HERZOG, Referee:

Fried, Beck & Tannenbaum, a creditor herein, moves to vacate the order of this court dated August 29, 1968 which restrains them from proceeding further with a motion previously brought in the Supreme Court of the State of New York, County of New York, to punish the debtor for contempt. The contempt motion was based upon (1) an alleged transfer of property by the debtor in violation of a restraining notice and (2) failure of the debtor to appear at an examination in proceedings supplementary to judgment.

The material facts are not in dispute. On July 2, 1964, debtor executed a confession of judgment in favor of the creditor and on January 19, 1965 judgment was entered against the debtor in the New York County Clerk's office for $51,520.00.

Approximately one year later, on January 10, 1966, debtor was served with a "restraining notice" pursuant to §5222 of the New York Civil Practice Law and Rules.[1] On March 16, 1967 debtor was served with a subpoena pursuant to CPLR §5224[2] requiring debtor's attendance for the taking of a deposition.

The deposition was adjourned by mutual consent from time to time, began on May 8, 1968, and was continued on June 7, 1968. Subsequently on two occasions, July 9, 1968

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[1] "(a) Issuance; on whom served; form; service. A restraining notice may be issued by the clerk of the court or the attorney for the judgment creditor as officer of the court. It may be served upon any person. It shall be served personally in the same manner as a summons or by registered or certified mail, return receipt requested. It shall specify all of the parties to the action, the date that the judgment was entered, the court in which it was entered, the amount of the judgment and the amount then due thereon, the names of all parties in whose favor and against whom the judgment was entered, and it shall set forth subdivision (b) and shall state that disobedience is punishable as a contempt of court.

(b) Effect of restraint; prohibition of transfer; duration. A judgment debtor served with a restraining notice is forbidden to make or suffer any sale, assignment, transfer or interference with any property in which he has an interest, except upon direction of the sheriff or pursuant to an order of the court, until the judgment is satisfied or vacated."

[2] "(a) Kinds and service of subpoena. Any or all of the following kinds of subpoenas may be served:

1. A subpoena requiring attendance for the taking of a deposition upon oral or written questions at a time and place named therein;"

and July 30, 1968, debtor appeared by attorney who said that debtor was on call but would not proceed with the deposition until the court rules upon his oral application for a stay or adjournment of the examination.

Regarding the alleged violation of the "restraining notice", applicant avers that debtor's 1967 tax return indicates the $8,389 purchase of certain shares, later sold for $5,132; that he sold 28,000 shares of Webb & Knapp, Inc. for $1,542; that he pledged 100 shares of a certain corporation worth at least $10,000; and that he sold $3,000 worth of personal property in 1967 or 1968.

On July 31, 1968 applicant moved in the Supreme Court, New York County, for an order adjudging debtor in contempt. After hearing the motion on August 5, 1968, Supreme Court Justice Gellinoff granted debtor "an opportunity to cure his default by appearing for examination on five days written notice." The motion was thus denied on condition that debtor appear "for examination, otherwise it will be granted on reapplication to the Court."

As regards that portion of the motion pertaining to the alleged violation of the restraining notice, it was granted only to the extent of designating a Special Referee to hear and report on whether debtor knew of the restraining notice "allegedly served upon him and whether or not there has been a wilful neglect to comply with the terms".

The debtor did appear on August 19, 1968 for examination, but a dispute arose as to the production of certain documents. Judge Gellinoff's secretary (with consent of the parties) ruled that the records be produced and the examination continue on August 21, 1968. The debtor appeared on August 21, 1968, without the records, and his counsel offered to read a list made from debtor's records. Apparently, this was unsatisfactory to the applicant's attorney, but what occurred thereafter does not appear.

On August 29, 1968, debtor filed his petition for an Arrangement, and on the same day the restraining order now sought to be vacated was duly entered. Nothing further was done by applicant until the instant motion made on May 7, 1969 and first returnable May 23, 1969 whereby applicant seeks vacatur of the aforesaid restraining order of August 29, 1969.

Section 11a of the Bankruptcy Act affords protection to a bankrupt from the harassment of suits founded upon claims from which a discharge would be a release. It provides:

> "A suit which is founded upon a claim from which a discharge would be a release, and which is pending against a person at the time of the filing of a petition by or against him, shall be stayed until an adjudication or the dismissal of the petition; if such person is adjudged a bankrupt, such action may be further stayed until the question of his discharge is determined by the court after a hearing, or by the bankrupt's filing a waiver of, or having lost, his right to a discharge, or, in the case of a corporation, by its failure to file an application for a discharge within the time prescribed under this Act: *Provided, however,* That such stay shall be vacated by the court if, in a proceeding under this Act commenced within six years prior to the date of the filing of the petition in bankruptcy, such person has been granted a discharge, or has had a composition confirmed, or has had a wage earner's plan by way of composition confirmed."

Section 314 of the Act confers upon the Chapter XI court, in addition to the injunctive powers possessed under §11a, injunctive powers to stay commencement or continuation c suits until final decree:

> "The court may, in addition to the relief provided t section 11 of this Act and elsewhere under this chapt enjoin or stay until final decree the commencement c continuation of suits other than suits to enforce lie upon the property of a debtor, and may, upon notice ar for cause shown, enjoin or stay until final decree ar act or the commencement or continuation of any pr ceeding to enforce any lien upon the property of debtor."

Section 314 confers a wider injunctive remedy than do §11a since under its broad provisions it is immaterial th the claim of the creditor upon which suit is founded, is n dischargeable. *See In re Cloisters Bldg. Corp.*, 79 F. 2 694, (7th Cir. 1935), *cert. denied*, 296 U.S. 657 (1936) (d cided under former §77B).

The power to enjoin state court proceedings has alwa been limited except in the field of bankruptcy. In the ad ministration of the bankrupt's estate jurisdiction to sta suits is necessary to implement and give effect to the pu poses of the Act. (1 *Collier on Bankruptcy*, 14th Ed. 1138). In Chapter XI proceedings this power is enlarged order to support its rehabilitation purposes.

Nevertheless, the bankruptcy court has often declined t raise its hand to stay proceedings for the enforcement of contempt order of a state court, recognizing that punish ment of an offender for contempt is a vindication of th dignity of the court. *Matter of Metz*, 6 F. 2d 962 (2d Ci 1925); *In re Koronsky*, 170 F. 719 (2d Cir. 1909).

This policy has resulted in some sweeping generalizatio as exemplified by decisions such as *In re Bell*, 53 F. Sup 993, 994 (E.D.N.Y. 1943):

> "The injunction issued by the Court did not and cou not restrain an application to punish the bankrupt f a contempt of the State Court."

Unfortunately, such decisions do not look behind th "contempt" label while denying the injunctive relief intende by the provisions of the Bankruptcy Act. There is nothi sacrosanct about the word "contempt" and it would see that the particular contempt proceedings should be scrut nized to determine whether they are aimed at punishing affront to the dignity of the court or whether they are but step in the collection of a judgment.

This is not by any means an original thought. Jud Goodard expressed the same notion succinctly in *In Lenoble*, 79 F. Supp. 457, 458 (S.D.N.Y. 1948), whe he said:

> "If the contempt proceeding is a step to collect th judgment, then it is properly restrained. . . . The r straining order staying the taking of further steps collect a judgment is proper."

In *In re Fortunato*, 123 F. 622 (S.D.N.Y. 1903), th bankrupt had failed to appear in supplementary proce ings and was ordered to pay a fine in the amount of th judgment and costs. In granting the injunctive relief, Jud Holt recognized the distinction between contempts whi are an affront to the dignity of the court and those whi are merely proceedings to collect a judgment.

> "Undoubtedly, a court may, on its own motion, puni for a contempt, but such a contempt as took place this case was inherently entirely different from a co tempt which courts ordinarily punish on their own m tion, such as, for instance, a personal insult offered the court. A proceeding for punishing a person for

fusal to comply with an order of the court on the ground that it is contempt is usually in substance a mere proceeding in an action, instigated and carried on by a party to the action or his attorney, as a step in the prosecution of the suit. In this case the fine was measured by the amount of the judgment and the attorney's costs in the special proceeding. It was directed to be paid to the judgment creditor or his attorneys. It was not at all in the nature of a punishment inflicted by the court on its own motion, for the protection of its own dignity, but was simply a proceeding carried on by the plaintiff's attorneys for the purpose of collecting the judgment." 123 F. at 624.

In *Matter of Adler*, 144 F. 659 (2d. Cir.), *cert. denied*, 201 U. S. 647 (1906), the order complained of restrained during the pendency of the proceedings, a judgment creditor from attempting to enforce its judgment by proceedings to punish the bankrupt for contempt. The court said:

"It would seem, therefore, that it was the duty of the court to stay the contempt proceedings if the claim were one which could be proved and discharged in bankruptcy; surely to do so was within the sound discretion of the judge". 144 F. at 661.

In *Matter of Koronsky*, 170 F. 719 (2d Cir. 1909), cited by the applicant herein, the particular contempt of which Koronsky was found guilty and for which he was fined was a deceit practiced upon the court in moving to vacate a default judgment on perjurious affidavits. The court held that "[m]anifestly, the offense was one peculiarly against the court, and of the sort where the punishment of the offender is a vindication of the dignity of the court . . . ." *Koronsky* did not find it necessary to say what the attitude of the court would be if the particular contempt, rather than constituting an offense against the dignity of the court, was but a step initiated by the judgment creditor to effect collection of his judgment. But the language employed would seem to indicate that under such circumstances injunctive relief would not be withheld.

In re Spagat, 4 F. Supp. 926 (S.D.N.Y. 1933), also cited by applicant herein, involved the disobedience of an *order* signed by the judge requiring appearance of the bankrupt for examination proceedings supplementary to judgment. Judge Patterson ruled that the contempt order did not attempt to interfere with the property which passed to the control of the court but "[sought] merely to vindicate its dignity which had been affronted by the contumacious conduct of a person who ignored its order". *Id.* at 927. Although this case might well be distinguished from the case at bar because it involved a violation of an *order* of the court rather than a "restraining notice" and a subpoena, I believe a more forthright approach requires me to express my disagreement with the conclusion reached. Had Judge Patterson been called upon by counsel to consider the distinction I seek to make between a contempt arising from a direct affront to the dignity of the court and a nominal contempt which is nothing but a step in the enforcement of a judgment, he might well have held otherwise.

If the purpose of §11a is to relieve the bankrupt from unnecessary harassment by creditors, as Judge Patterson pointed out in *In re S. W. Straus & Co.*, 6 F. Supp. 547, 548 (S.D.N.Y. 1934), then surely the court should enjoin a technical contempt proceeding which looks to collection of a judgment rather than to vindicate the dignity of the court.

While it is undoubtedly true that a true contempt involving an affront to the dignity of the court does not lose that character because of statutory authorization to turn over the amount of the fine to the person aggrieved by the offender's conduct, 170 F. at 720, it seems to me that where such an affront is not involved, and where the relief sought is a fine in the amount of the judgment and payable to the judgment creditor, it is an indication that the major purpose of the proceeding is the enforcement of the money judgment. This is an important consideration, for, should the bankrupt later win a discharge, the situation would be one where the creditor would obtain payment out of the bankrupt's earnings after adjudication, in violation of a fundamental purpose of the Bankruptcy Act. See *In re Brecher*, 19 F. Supp. 283 (S.D.N.Y. 1937, Patterson, J.).

In re Thomashefsky, 51 F. 2d 1040 (2d. Cir. 1931), cited by applicant herein, is distinguishable from the instant case in that the fine for contempt was imposed before bankruptcy intervened, and on that ground was held non-dischargeable. Furthermore, here again, the court did not consider the distinction between an affront to the dignity of the court and a technical contempt arising from failure to appear in supplementary proceedings.

This distinction was clearly noted in *Parker v. United States*, 153 F. 2d 66, 70 (1st Cir. 1946) where a compensatory fine had been imposed prior to bankruptcy:

"Proceedings in civil contempt are between the original parties and are instituted and tried as a part of the main cause. Though such proceedings are "nominally those of contempt" (Worden v. Searls, 1887, 121 U.S. 14, 26, 7 S. Ct. 814, 820, 30 L.Ed. 853), the real purpose of the court order is purely remedial — to coerce obedience to a decree passed in complainant's favor, or to compensate complainant for loss caused by respondent's disobedience of such a decree. . . . In this respect the situation is unlike that of criminal contempt where the court in its discretion may withhold punishment for the past act of disobedience. An order imposing a compensatory fine in a civil contempt proceeding is thus somewhat analogous to a tort judgment for damages caused by wrongful conduct."

Although the question of the dischargeability of a fine which may be imposed in the instant case is not material at the moment because stays granted under §314 do not depend upon dischargeability, the question may become material should the Chapter XI proceedings abort and the debtor be adjudged a bankrupt. Therefore it is interesting to note what the court said in *Parker* as to dischargeability of a compensatory fine:

"But there would seem to be no a priori reason why liability for a compensatory fine imposed in a civil contempt proceeding should not be deemed a "debt" within the meaning of § 1(14) of the Bankruptcy Act, and a provable debt under § 63, 11 U.S.C.A. § 103. . . . As we have seen, a complainant who has obtained a court decree in his favor is entitled as of right to such a remedial order against a person whose disobedience of the decree has caused complainant loss, an order imposing a compensatory fine in a civil contempt proceeding being not unlike a tort judgment for money damages caused by wrongful conduct. Within the meaning of § 63, sub. a (1), it would seem to be "a fixed liability, as evidenced by a judgment . . . absolutely owing at the time of the filing of the petition" in bankruptcy." 153 F. 2d at 71.

Distinguishing the cases which hold fines to be non-dischargeable the court said in *Parker:*

"Some of them contain the unqualified statement that

fines for contempt of court are not dischargeable in bankruptcy. But in none of them does it distinctly appear that the fine in question was a compensatory fine imposed in a strictly civil contempt proceeding, and in none of them is there any considered discussion of the differing characteristics of criminal and civil contempt proceedings." *Id.* at 73.

Turning now to the case *sub judice*, both of the alleged contempts are of the "nominal" or "technical" variety. The first related to a purported violation of a "restraining notice", and the second, to a failure to appear for an examination pursuant to subpoena. Both remedies are found in Article 52 of the New York Civil Practice Law & Rules (CPLR) which is entitled "MONEY JUDGMENTS — ENFORCEMENT", and failure to comply with the restraining notice or subpoena is made punishable as a contempt of court by CPLR §5251.[3]

The facts relating to the alleged violation of the "restraining notice" and the subpoena for examination in supplementary proceeding, and Judge Gellinoff's disposition of the motion for contempt have been recited above. The posture of the contempt proceedings remains unchanged to this day. By reason of the stay issued by this court the debtor has not been further examined in supplementary proceedings, nor has the Special Referee designated by Judge Gellinoff conducted hearings. Consequently, as at this date the debtor has not been adjudged guilty of contempt.

Regarding the supplementary proceeding examination, I am satisfied that in its present position, in view of Judge Gellinoff's ruling, it is nothing other than a step to effect collection of the judgment. Debtor is before this court and is subject to searching examinations pursuant to §21a of the Act. The applicant is a creditor and should it desire to conduct an examination to disclose or uncover assets or to establish transfers of property or improprieties which would bar confirmation of an arrangement, the way is open to it. This is the proper forum for such an examination. The entire creditor body is entitled to any benefits which may be the consequence of such examination.

The alleged violation of the restraining notice poses a more serious problem. However, I am satisfied that if, indeed, debtor was guilty of contempt, it was a "technical" or "nominal" contempt. The disobedience was of a "notice" and not of an order made by the judge. It was not a contempt committed in the presence of the court; it was not that species of contempt which every court has inherent power to punish in order to uphold and protect its dignity. It was a contempt only because CPLR §5251 makes it so. The application to punish for contempt asks that debtor be fined the value of the property transferred in violation of the restraining notice and that such fine be paid over to applicant in reduction of its judgment. This may not alter the character of a true contempt, but it certainly indicates that pursuit of this technical contempt is but another step in the effort to collect the judgment.

Why the applicant "sat on its rights" for nine months before moving to vacate the restraining order I do not know. Debtor's counsel argues that applicant's *laches* should bar it from invoking the equitable power. I do not see that the equitable power of the bankruptcy court is involved. It is true that §314 of the Act vests discretionary power in the court to enjoin commencement or continuance of suits, but §11a provides that the court "shall" stay suits founded upon dischargeable debts. Be that as it may, it seems to me that the applicant's laches may indeed be a factor to be considered as an indication that the alleged contempts were not regarded so grave an affront to the state court as to require prompt discipline.

The motion to vacate the stay is denied.

Settle order in conformity with the foregoing upon three days notice.

DATED: NEW YORK, NEW YORK
August 13, 1969

s/Asa S. Herzog
REFEREE IN BANKRUPTCY

[3] "Failure of any person to comply with a subpoena or restraining notice issued or order granted, pursuant to this title . . . shall each be punishable as a contempt of court".

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

- x

In the Matter of ALPHONSE GUARIGLIA,

Bankrupt, Appellee, :

- against - No. 74-2440

COMMUNITY NATIONAL BANK AND TRUST COMPANY,

:

Creditor, Appellant.

- x

AFFIDAVIT OF SERVICE BY MAIL

STATE OF NEW YORK)
) SS.:
COUNTY OF NEW YORK)

SUSAN BAUER, being duly sworn, deposes and says:

1. That the deponent is not a party to the action, is over 18 years of age, and resides in Forest Hills, Queens, New York.

2. That on the 2nd day of January, 1975, the deponent served the within brief upon Reuben E. Gross, attorney for creditor-appellant, at 30 Bay Street, Staten Island, New York 10301, by depositing two true copies thereof in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody

of the United States post office department within the State of New York.

Susan Bauer

SUSAN BAUER

Sworn to before me this
2nd day of January, 1975.

Elaine C. Buck

ELAINE C. BUCK
Notary Public, State of New York
No. 4604473
Qualified in New York County
Term Expires March 30, 1975